

Portfolio of the Executive Member for Finance & Performance

Report of the Head of Corporate Finance & Commercial Procurement (interim s151 officer)

Partner Authority Investment in relation to the Yorkshire Purchasing Organisation

Purpose of Report

1. To provide Executive with an overview of a proposed transaction by the Yorkshire Purchasing Organisation (YPO) and the opportunity to consider the business case, risk profile and finance options in order to inform the decision to be taken at YPO Management Committee.
2. To allow Executive the opportunity to consider proposed amendments to the governance arrangements of YPO. These have been proposed by Wakefield Council, as the lead authority on behalf of YPO, and are intended to safeguard the arrangements for the benefit of all founder members should the YPO Management Committee resolve to pursue this transaction.

Recommendation

3. That Executive considers the transaction proposed by YPO as outlined in the report and exempt appendices and indicate the Councils view on the proposal to inform a vote at YPO Management Committee.
4. That Executive confirms its financial backing for the transaction by agreeing to underwrite a loan through entering into a supplemental agreement and delegate authority to the Chief Executive to approve the supplemental agreement set out at appendix 4 subject to
 - i. At least 10 of the 13 founder members remaining at founder members and agreeing to enter into the supplemental agreement
 - ii. The satisfactory completion of legal and financial due diligence on the proposal giving confidence to process and
 - iii. A resolution of the YPO Management Committee to enter into the transaction.

Reasons:

- To enable YPO to continue to provide benefits to members into the long term.

Background

5. YPO was founded in 1974 and is a joint local government service for procurement of goods and services. The membership has changed over the years but currently comprises 13 'founder member' local authorities; Barnsley, Bolton, Bradford, Calderdale, Doncaster, Kirklees, Knowsley, North Yorkshire, Rotherham, St Helens, Wakefield, Wigan and York.
6. Wakefield Council currently acts as the 'Lead Authority' providing a range of services to YPO including employing YPO's staff, providing internal audit and s151 and Monitoring Officer functions.
7. The YPO is currently governed by a management agreement (at Appendix 4) dated September 2011 which designates as Founder Members the 13 Authorities who participate in YPO under a Joint Committee arrangement established under sections 101 and 102 of the Local Government Act 1972 and The Local Authorities (Arrangements for the Discharge of Functions)(England) Regulations 2000. Under the Management Agreement, each founder member has one vote at the Management Committee and these votes are of equal standing. No single council/founder has a controlling interest. Founder members are entitled to dividends and to vote on how the dividends are allocated amongst YPO members. The Management Committee is supported by an advisory strategic officer group which includes relevant officers from each founder member council.
8. In addition, there are two further categories of membership, 'associate membership' and 'ordinary membership'. Neither category has a substantive role in the governance but as customers of YPO are entitled to a dividend paid from any surplus accumulated by YPO in a financial year. Associate members (and founder members) receive a dividend in cash. Ordinary members receive their dividend in the form of discounts on future purchases. In addition to achieving a range of non-financial benefits, the YPO has been successful in delivering benefits to the members with the dividend for York over the last full year of operation amounting to £260k.

9. The combination of increasing operating costs and an increasingly competitive market environment has meant that YPO has been considering for some time the opportunity for new business strategies and diversification in order to safeguard and promote its strategic objectives. The YPO management team considers that the majority of the opportunities to cut costs have now been taken. Some further investment in the business will be needed in the medium term and growth into new markets, whilst positive, will be a protracted process. Thus it will become increasingly difficult to keep dividends at current levels. This has led to the proposed transaction more fully described in the exempt appendices.
10. The due diligence is expected to conclude in early December and arrangements have been made for relevant officers to meet with the external advisors to receive the outcome. This will allow the relevant statutory officers to review the due diligence work that has been undertaken by the consultants.
11. The proposal is that the lead authority provides the funding and makes the transaction on behalf of all the founder members. Founder members will be asked to stand behind the lead authority's position through a supplemental agreement which will outline the position should a founder member wish to withdraw during the loan period or if the Joint Committee terminates with liabilities in excess of assets.
12. In order to safeguard the position of founder members who will be carrying the risk of the proposed transaction it is recommended that each founder member enter into a supplemental agreement, which amends the Management Agreement. This will require any authority serving notice to leave YPO during the 10 year loan period to accept a contingent liability for an equal share of the loan outstanding at that time (principal sum and interest) to be paid if YPO is later wound up and asset are insufficient to cover the liability. The agreement ring-fences an element of the dividends to be paid to founder members along with a specific requirement for the management committee to have regard to the risk carried by founder members when setting the split of dividends between founder and associate members. If all 13 founder members wish to proceed and accept this supplemental agreement the risk to each is a 1/13th share of the loan. Should any founder members choose to withdraw before the proposed transaction it is suggested that, as long as 10 founder members remain and enter in to the supplemental agreement, the rise in risk level is acceptable given the potential benefits.

Consultation

13. The proposed transaction has been discussed with YPO strategic officers from each of the founder members, including s151 and monitoring officers (or their representatives). The proposed transaction has also been considered by elected members at the YPO management committee who resolved to take the proposal to the next stage and commission external financial and legal advisors to undertake due diligence.

Options

14. Option 1 – confirm support for the proposed transaction and agree to enter into the supplemental agreement. This will allow the lead authority to borrow and acquire on behalf of YPO to expand and consolidate the business. There will be a protection of the position of the founder members who will receive a ring-fenced dividend before further distribution with the comfort that other founder members will accept a contingent liability for the loan through the supplemental agreement in the event that they wish to withdraw from YPO during the loan period. This option is recommended for the reasons set out in the appendices.
15. Option 2 - do not support the proposed transaction and supplemental agreement. Should the YPO Management Committee still resolve to go ahead with the transaction and if two thirds of members resolve to enter into a supplemental agreement (which amends the Management Agreement) the council could be in a position of taking on risk without being able to withdraw in advance. YPO does not want to put founder members in such a position. For that reason it is suggested that any council who is fundamentally opposed to the transaction should have the opportunity to withdraw from the YPO, without the formal 12 months notice, on 31 December 2019 with an option of transferring to associate member status. Taking this option would mean that the council is not exposed to risk of the transaction and loan but would mean that the council would not receive dividend payments after 2019. This option is therefore not recommended.

Council Plan

16. The council participates in YPO as a high quality public sector procurement organisation that maintains effective, efficient and economical arrangements for the supply of goods, materials, works and services by providing excellent quality, service and competitive prices while optimising the profits available for distribution to its members and customers.

17. YPO delivers social value for all founder members through its procurement policies which actively seek to engage with local businesses and encourage YPO supply chains to measure and embed social impact. YPO annually publishes the social, economic and environmental impact of its procurement through its annual benefits statement.

Implications

18. **Financial** – the proposed transaction is set out in detail in the confidential appendices to this report. The strategic business case, which models the forecast income and expenditure over a ten-year period, outlines potentially significant financial and non-financial benefits to the YPO, its customer, the Founder Members, and the wider public sector.
19. External financial advice has been commissioned to undertake financial due diligence. This due diligence is expected to be completed by early December.
20. There is a financial risk arising from the proposed acquisition. To help mitigate this, the business case has been based on a prudent set of assumptions around and has been risk-assessed and stress-tested to financially model different scenarios. In addition, there will be dedicated project management resource deployed to support transitional arrangements and strengthened senior capacity at board level. A full risk assessment and potential mitigation is set out in the appendices.
21. The proposal is that Wakefield Council, as the Lead Authority, would provide the funding and make the transaction on behalf of all of the Founder Members. Founder Members will be asked stand behind the Lead Authority's position through an addendum to the Management Agreement which will outline the position should a founder member wish to withdraw during the loan period or if the Joint Committee terminates with liabilities in excess of assets.
22. **Legal** - YPO is a public sector procurement organisation operated through a Joint Committee structure. The final approval of the proposed transaction will be taken at YPO Management Committee in the light of decisions on the matters set out in this report by all Founder Members.
23. External legal advice has been taken on the powers of Founder Members to undertake this transaction.

24. The business of the YPO primarily relies on the powers under s111 Local Government Act 1972 and the Local Authority (Goods and Services) Act 1970. However where YPO wishes to trade with organisations that are not covered by such legislation it can rely on the General Powers of Competence (“GPOC”) under Section 1 of the Localism Act 2011. Section 4 of the Localism Act 2011 enables the local authority to do for a commercial purpose anything that it is empowered to do under GPOC. The section 4 trading powers prescribe which company structures may be used. In short, given the trading mix of the target company and commercial scale the more resilient basis of reliance in powers is GPOC and the acquisition of the shares in the existing target company satisfies the requirement that such powers be exercised through a company.
25. Additional reliance can be placed on Section 95 of the Local Government Act 2003 enables relevant authorities “to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions” i.e. anything which they are empowered to do in legislation. The section 95 power can be limited by order and authorities exercising it must have regard to the guidance issued by the Secretary of State. To adhere to the requirements under this legislation the local authority must prepare a business case supporting the exercise of the section 95 power, which the authority must approve (Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009). In the event that YPO Proceed with the transaction and subsequently trade through a company for a period of time, then the business case appended to this report as Appendix 1 satisfies the requirements of the Local Government Power to Trade Order for Wakefield as the Lead Authority holding the assets in Trust.
26. Once acquired, YPO can reorganise the business of the target to achieve the most cost effective delivery of service which will allow trading with designated public bodies to be done other than through the Company
27. There are no Human Resources (HR), One Planet Council / Equalities, Crime and Disorder, Information Technology (IT), Property or Other implications.

Risk Management

28. The risks are set out in the confidential appendix 2 attached to this report.

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	Report Approved	x	Date 14.11.19
Wards Affected: <i>All</i>			
<i>For further information please contact the author of the report</i>			

Appendices

1. Business case – exempt from publication
2. Risk profiling – exempt from publication
3. Finance model – exempt from publication
4. Draft supplemental agreement – exempt from publication
5. Existing management agreement